

Assembly Bill No. 2347

CHAPTER 569

An act to amend Sections 16340, 16363, and 16364 of, to add Section 16374.5 to, and to repeal and add Section 16361 of, the Probate Code, relating to trusts.

[Approved by Governor September 28, 2006. Filed with
Secretary of State September 28, 2006.]

LEGISLATIVE COUNSEL'S DIGEST

AB 2347, Harman. Trusts: distributions.

Existing law governs the distribution of income from a trust after an income interest in a trust ends. Existing law also specifies the distribution of interest and accrued income on a specific devise under a will where the intention of the testator is not otherwise indicated by the will.

This bill would provide that a specific gift distributable under a trust shall carry with it the same benefits and burdens as a specific devise under a will. The bill would both expand the definition of, and revise the provisions governing the allocation of, payments received by a trustee. The bill would specify and clarify the allocation of receipts from interests owned by a trust in specified natural resources and limit trustee liability for making that allocation, as specified. The bill would also set forth a priority of sources from which distributions from a trust payable to beneficiaries would be made, except as otherwise provided by the governing instrument, as determined by the trustee, or as ordered by the court.

The people of the State of California do enact as follows:

SECTION 1. Section 16340 of the Probate Code is amended to read:

16340. After the decedent's death, in the case of a decedent's estate, or after an income interest in a trust ends, the following rules apply:

(a) If property is specifically given to a beneficiary, by will or trust, the fiduciary of the estate or of the terminating income interest shall distribute the net income and principal receipts to the beneficiary who is to receive the property, subject to the following rules:

(1) The net income and principal receipts from the specifically given property are determined by including all of the amounts the fiduciary receives or pays with respect to the property, whether the amounts accrued or became due before, on, or after the decedent's death or an income interest in a trust ends, and by making a reasonable provision for amounts

the fiduciary believes the estate or terminating income interest may become obligated to pay after the property is distributed.

(2) The fiduciary may not reduce income and principal receipts from the specifically given property on account of a payment described in Section 16370 or 16371, to the extent that the will, the trust, or Section 12002 requires payment from other property or to the extent that the fiduciary recovers the payment from a third person.

(3) A specific gift distributable under a trust shall carry with it the same benefits and burdens as a specific devise under a will, as set forth in Chapter 8 (commencing with Section 12000) of Part 10 of Division 7.

(b) A general pecuniary gift, an annuity, or a gift of maintenance distributable under a trust carries with it income and bears interest in the same manner as a general pecuniary devise, an annuity, or a gift of maintenance under a will, as set forth in Chapter 8 (commencing with Section 12000) of Part 10 of Division 7. The fiduciary shall distribute to a beneficiary who receives a pecuniary amount, whether outright or in trust, the interest or any other amount provided by the will, the trust, this subdivision, or Chapter 8 (commencing with Section 12000) of Part 10 of Division 7, from the remaining net income determined under subdivision (c) or from principal to the extent that net income is insufficient.

(c) The fiduciary shall determine the remaining net income of the decedent's estate or terminating income interest as provided in this chapter and by doing the following:

(1) Including in net income all income from property used to discharge liabilities.

(2) Paying from income or principal, in the fiduciary's discretion, fees of attorneys, accountants, and fiduciaries, court costs and other expenses of administration, and interest on death taxes, except that the fiduciary may pay these expenses from income of property passing to a trust for which the fiduciary claims an estate tax marital or charitable deduction only to the extent that the payment of these expenses from income will not cause the reduction or loss of the deduction.

(3) Paying from principal all other disbursements made or incurred in connection with the settlement of a decedent's estate or the winding up of a terminating income interest, including debts, funeral expenses, disposition of remains, family allowances, and death taxes and related penalties that are apportioned to the estate or terminating income interest by the will, the trust, or Division 10 (commencing with Section 20100).

(d) After distributions required by subdivision (b), the fiduciary shall distribute the remaining net income determined under subdivision (c) in the manner provided in Section 16341 to all other beneficiaries.

(e) For purposes of this section, a reference in Chapter 8 (commencing with Section 12000) of Part 10 of Division 7 to the date of the testator's death means the date of the settlor's death or of the occurrence of some other event on which the distributee's right to receive the gift depends.

(f) If a trustee has distributed a specific gift or a general pecuniary gift before January 1, 2007, the trustee may allocate income and principal as

set forth in this chapter or in any other manner permissible under the law in effect at the time of the distribution. If the trustee distributes a specific gift or a general pecuniary gift after December 31, 2006, then the trustee shall allocate income and principal as provided in this chapter.

SEC. 2. Section 16361 of the Probate Code is repealed.

SEC. 3. Section 16361 is added to the Probate Code, to read:

16361. (a) For purposes of this section, “payment” means either of the following:

(1) A payment that a trustee may receive over a fixed number of years or during the life of an individual because of services rendered or property transferred to the payer in exchange for future payments.

(2) A payment that a trustee may receive pursuant to an income tax advantaged contractual, custodial, or trust arrangement, including, but not limited to, a private or commercial annuity, a pension or profit-sharing plan, an individual retirement account, Roth IRA, or any similar arrangement, regardless of whether the payment is made from an “entity” as defined in Section 16350.

(b) To the extent that a payment is characterized by the payer as interest or a dividend or a payment made in lieu of interest or a dividend, a trustee shall allocate it to income. The trustee shall allocate to principal the balance of the payment and any other payment received in the same accounting period that is not characterized as interest, a dividend, or an equivalent payment.

(c) If no part of a payment is characterized as interest, a dividend, or an equivalent payment, the trustee shall allocate the payment as follows:

(1) If the payment is received from an individual account, the trustee shall allocate the payment to income to the extent that the payment, when combined with all other payments received from the individual account during that same accounting period, which may be referred to as the “cumulative amount received,” does not exceed 4 percent of the account value, which may be referred to as the “income allocation amount.” To the extent that any portion of a payment causes the cumulative amount received to exceed the income allocation amount, that portion, together with all further amounts received from the individual account during that accounting period, shall be allocated to principal.

(A) As used in this section, the term “individual account” means an individual account plan as defined in the Employee Retirement Income Security Act of 1974 (29 U.S.C. 1001 et seq.), as amended from time to time, and any other plan, account, or arrangement whose terms enable the trustee to identify the fair market value of the participant’s or owner’s interest therein.

(B) As used in this section, the term “account value” means the fair market value of the individual account as of the later of the last day of the trust’s preceding accounting period and the date when the right to receive payments from the individual account first became subject to the trust.

(C) If an accounts period consists of less than 365 days, the income allocation amount shall be prorated on a daily basis.

(2) If the payment is received from a plan, account or other arrangement that is not an individual account, the trustee shall allocate the payment as follows:

(A) If all or part of the payment is required to be made to the trustee, the trustee shall allocate to income 10 percent of the part that is required to be made during the accounting period and the balance to principal.

(B) If no part of a payment is required to be made to the trustee or the payment received is the entire amount to which the trustee is entitled, the trustee shall allocate the entire payment to principal.

(C) A payment is not “required to be made” to the extent that it is made because the trustee exercises a right of withdrawal.

(d) If, to obtain an estate tax marital deduction for a trust, a trustee must allocate more of a payment to income than provided by this section, the trustee shall allocate to income the additional amount necessary to obtain the marital deduction.

SEC. 4. Section 16363 of the Probate Code is amended to read:

16363. (a) To the extent that a trustee accounts for receipts from an interest in minerals, water, or other natural resources pursuant to this section, the trustee shall allocate them as follows:

(1) If received as a nominal bonus, nominal delay rental, or nominal annual rent on a lease, a receipt shall be allocated to income.

(2) If received from a production payment, a receipt shall be allocated to income if and to the extent that the agreement creating the production payment provides a factor for interest or its equivalent. The balance shall be allocated to principal.

(3) If an amount received as a royalty, shut-in-well payment, take-or-pay payment, bonus, or delay rental is more than nominal, 90 percent shall be allocated to principal and the balance to income.

(4) If an amount is received from a working interest or any other interest in mineral or other natural resources not described in paragraph (1), (2), or (3), 90 percent of the net amount received shall be allocated to principal and the balance to income.

(b) An amount received on account of an interest in water that is renewable shall be allocated to income. If the water is not renewable, 90 percent of the amount shall be allocated to principal and the balance to income.

(c) This chapter applies whether or not a decedent or donor was extracting minerals, water, or other natural resources before the interest became subject to the trust.

(d) If a trust owned an interest in minerals, water, or other natural resources on January 1, 2000, the trustee may at all times allocate receipts from the interest as provided in this chapter or in the manner reasonably used by the trustee prior to that date. Receipts from an interest in minerals, water, or other natural resources acquired after January 1, 2000, shall be allocated by the trustee as provided in this chapter. If the interest was owned by the trust on January 1, 2000, a trustee that allocated receipts from the interest between January 1, 2000, and December 31, 2006, as

provided in this chapter shall not have a duty to review that allocation and shall not have liability arising from the allocation. Nothing in this section is intended to create or imply a duty to allocate in a manner used by the trustee prior to January 1, 2000, and a trustee is not liable for not considering whether to make such an allocation or for choosing not to make such an allocation.

SEC. 5. Section 16364 of the Probate Code is amended to read:

16364. (a) To the extent that a trustee accounts for receipts from the sale of timber and related products pursuant to this section, the trustee shall allocate the net receipts as follows:

(1) To income to the extent that the amount of timber removed from the land does not exceed the rate of growth of the timber during the accounting periods in which a beneficiary has a mandatory income interest.

(2) To principal to the extent that the amount of timber removed from the land exceeds the rate of growth of the timber or the net receipts are from the sale of standing timber.

(3) To or between income and principal if the net receipts are from the lease of timberland or from a contract to cut timber from land owned by a trust, by determining the amount of timber removed from the land under the lease or contract and applying the rules in paragraphs (1) and (2).

(4) To principal to the extent that advance payments, bonuses, and other payments are not allocated pursuant to paragraph (1), (2), or (3).

(b) In determining net receipts to be allocated under subdivision (a), a trustee shall deduct and transfer to principal a reasonable amount for depletion.

(c) This chapter applies whether or not a decedent or transferor was harvesting timber from the property before it became subject to the trust.

(d) If a trust owned an interest in timberland on January 1, 2000, the trustee may at all times allocate net receipts from the sale of timber and related products as provided in this chapter or in the manner reasonably used by the trustee prior to that date. Net receipts from an interest in timberland acquired after January 1, 2000, shall be allocated by the trustee as provided in this chapter. If the interest was owned by the trust on January 1, 2000, a trustee that allocated net receipts from the interest between January 1, 2000, and December 31, 2006, as provided in this chapter shall not have a duty to review that allocation and shall not have liability arising from the allocation. Nothing in this section is intended to create or imply a duty to allocate in a manner used by the trustee prior to January 1, 2000, and a trustee is not liable for not considering whether to make such an allocation or for choosing not to make such an allocation.

SEC. 6. Section 16374.5 is added to the Probate Code, to read:

16374.5. Unless otherwise provided by the governing instrument, determined by the trustee, or ordered by the court, distributions to beneficiaries shall be considered paid in the following order from the following sources:

(a) From net taxable income other than capital gains.

- (b) From net realized short-term capital gains.
- (c) From net realized long-term capitalized gains.
- (d) From tax-exempt and other income.
- (e) From principal of the trust.